

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Sears Industries, Inc. :
AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Corporation :
Franchise Tax under Article 9A of the Tax Law for :
the Years Ending 12/31/79, 12/31/80 & 12/31/81. :
:

State of New York :

ss.:

County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 26th day of July, 1985, he served the within notice of Decision by certified mail upon Sears Industries, Inc., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Sears Industries, Inc.
800 Second Avenue
New York, NY 10017

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
26th day of July, 1985.

David Parchuck

James A. Haglund

Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Sears Industries, Inc. :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :
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Franchise Tax under Article 9A of the Tax Law for :
the Years Ending 12/31/79, 12/31/80 & 12/31/81. :

State of New York :

ss.:

County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 26th day of July, 1985, he served the within notice of Decision by certified mail upon Ludwig A. Suskar, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Ludwig A. Suskar
Smith, Sterbel, Alexander & Saskar
460 Park Ave.
New York, NY 10022

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
26th day of July, 1985.

David Parchuck

Conrad A. Negandhi
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

July 26, 1985

Sears Industries, Inc.
800 Second Avenue
New York, NY 10017

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Ludwig A. Suskar
Smith, Sterbel, Alexander & Saskar
460 Park Ave.
New York, NY 10022
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
	:	
of	:	
	:	
SEARS INDUSTRIES, INC.	:	DECISION
	:	
for Redetermination of a Deficiency or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Years Ended	:	
December 31, 1979, December 31, 1980 and	:	
December 31, 1981.	:	

Petitioner, Sears Industries, Inc., 800 Second Avenue, New York, New York 10017, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years ended December 31, 1979, December 31, 1980 and December 31, 1981 (File Nos. 39058 and 46152).

On October 25, 1984, petitioner, by its representative, Ludwig A. Saskor, Esq., filed a waiver of formal hearing and requested that this matter be decided by the State Tax Commission on the basis of the existing record and a stipulation of facts with all briefs to be submitted by January 10, 1985. After due consideration, the Tax Commission renders the following decision.

ISSUE

Whether petitioner was entitled to exclude certain income from subsidiary capital in computing its entire net income.

FINDINGS OF FACT

1. Petitioner, Sears Industries, Inc., timely filed New York State corporation franchise tax reports for each of the tax years 1979, 1980 and 1981. On each return, petitioner reported certain payments from the subsidiary

of its own wholly-owned subsidiary as dividends from a wholly-owned subsidiary, and deducted 100 percent of the payments in computing its entire net income.

2. On June 3, 1982, the Audit Division issued a Notice of Deficiency against petitioner in the amount of \$15,273.15, plus interest of \$4,254.43, for a total due of \$19,527.58, for the year ended December 31, 1979. On the same date, the Audit Division issued a Notice of Deficiency against petitioner in the amount of \$16,571.37, plus interest of \$3,860.73, for a total due of \$20,432.10 for the year ended December 31, 1980. On July 27, 1983, the Audit Division issued a third notice against petitioner in the amount of \$36,597.00, plus interest of \$7,835.42, for a total due of \$44,432.42 for the year ended December 31, 1981. The Audit Division based the deficiencies on the disallowance of the deduction of the payments from the third tier subsidiary on the ground that such subsidiary was not a wholly-owned subsidiary of petitioner.

3. Petitioner is a Maryland corporation. Valor Trading Corporation ("Valor") is a Delaware corporation and, during the years in issue, was wholly owned by petitioner. Miss Erika, Inc. ("Miss Erika") is a North Carolina corporation and, during the years in issue, was wholly owned by Valor. During the years in issue, all of the officers and directors of Valor were also officers and/or directors of petitioner. They received no compensation from Valor by way of salary, director's fees or otherwise.

4. During the years in issue, Valor was inactive; it was engaged in no business activity whatsoever. Valor had no assets other than the stock of Miss Erika. Valor had no office in New York or elsewhere and had no employees in New York or elsewhere. Additionally, Valor had no income and no bank accounts in New York or elsewhere. Valor was not required to file corporation franchise tax returns in New York during the years in issue.

5. During the years in issue, petitioner did not sell any goods or render any services to Miss Erika, nor was there any money owing from Miss Erika to petitioner on account of goods, services or otherwise. However, Miss Erika made the following payments to petitioner:

1979	-	\$ 700,000.00
1980	-	975,000.00
1981	-	1,070,000.00

Miss Erika did not formally declare a dividend for any of the years in issue.

6. Petitioner offered no evidence to indicate that the payments were loans, loan repayments or gifts, although petitioner argues that if the payments were not dividends or payments for goods or services rendered, they would necessarily be loans or gifts.

7. Petitioner claims that it had a beneficial interest in the stock of Miss Erika since petitioner was the sole shareholder of Valor which, in turn, was the sole shareholder of Miss Erika and that, therefore, Miss Erika should be considered petitioner's wholly-owned subsidiary entitling petitioner to the exclusion for income from a subsidiary. The Audit Division maintains that since petitioner was not the holder of record of the Miss Erika stock and showed no evidence of having any beneficial ownership of such stock, it could not claim Miss Erika as a subsidiary. On its franchise tax return, petitioner treated Miss Erika as a subsidiary for purposes of the tax on subsidiary capital and paid such tax.

8. If the Miss Erika payments had been paid to Valor instead of petitioner, and Valor had in turn paid dividends in the same amount to petitioner, then Valor would not have been required to pay any corporate franchise taxes to New York State on account of its receipt of the Miss Erika payments and the corporate

franchise taxes payable by petitioner to New York State would have been the same as reported on its returns.

CONCLUSIONS OF LAW

A. That section 208.9 provides, in pertinent part, that:

"The term 'entire net income' means total net income from all sources...

(a) Entire net income shall not include:

(1) income, gains and losses from subsidiary capital..."

B. That sections 208.3 and 208.4 of the Tax Law define "subsidiary" and "subsidiary capital" as follows:

"3. The term 'subsidiary' means a corporation of which over fifty per centum of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer;

4. The term 'subsidiary capital' means investments in the stock of subsidiaries and any indebtedness from subsidiaries, whether or not evidenced by written instrument, on which interest is not claimed and deducted by the subsidiary for purposes of taxation under articles nine-a, nine-b or nine-c of this chapter..."

C. That 20 NYCRR 3-6.2 further defines the term "subsidiary" as follows:

"(a) The term 'subsidiary' means a corporation which is controlled by the taxpayer, by reason of the taxpayer's ownership of more than fifty percent (50%) of the total number of the shares of stock of such corporation, issued and outstanding, which entitle the holder of the shares to vote at elections of its directors or trustees. The determination of whether or not particular shares of a corporation's stock entitles the holder of such shares to vote for the election of directors or trustees of the corporation depends on the actual legal situation with respect to voting rights, as it exists from time to time.

* * *

(b) The test of ownership is actual beneficial ownership, rather than mere record title as shown by the stock books of the issuing corporation. A corporation will not be considered to be a subsidiary because more than fifty percent (50%) of the shares of its voting stock is registered in the taxpayer's name, unless the taxpayer is the actual beneficial owner of such stock. However, a corporation will not be considered a subsidiary if more than fifty percent (50%)

of the shares of its voting stock is not registered in the taxpayer's name, unless the taxpayer submits proof that it is the actual beneficial owner of such stock.

* * *

(d) In any case where the record holder of shares of voting stock of a corporation is not the actual beneficial owner of the stock, or where the right to vote such stock is not possessed by the record holder or by the actual beneficial owner of the stock, a full and complete statement of all relevant facts must be submitted."

D. That the concept of beneficial ownership of stock does not apply to situations involving three or more tier corporate structures unless there has been some transfer of rights in the stock, for example, where there has been a transfer of stock without transfer of legal title or where the transferee of the stock is not yet the holder of record on the books of the corporation, or where there has been a transfer to a trustee. (See generally Yelencsics v. Commissioner, 74 T.C. 1513; Flagg-Utica Corp. v. Baseline, 14 Misc.2d 476.) There is no evidence in the record indicating that petitioner received beneficial ownership of the stock of Miss Erika so as to entitle petitioner to claim Miss Erika as a wholly-owned subsidiary for purposes of section 208.9 of the Tax Law.

E. That since petitioner was not the owner of any stock of Miss Erika during the years in issue, Miss Erika cannot be considered to be a subsidiary of the petitioner as defined in 20 NYCRR 3-6.2(a) and section 208.3 of the Tax Law. Thus the payments received by petitioner from Miss Erika during said years did not constitute income from subsidiary capital and were subject to corporation franchise tax in accordance with the meaning and intent of section 208.9(a)(1) of the Tax Law.

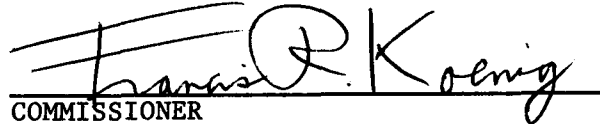
F. That the petition of Sears Industries, Inc. is denied and the notices of deficiency dated June 3, 1982 and July 27, 1983 are sustained.


DATED: Albany, New York

STATE TAX COMMISSION

JUL 26 1985


PRESIDENT


COMMISSIONER


COMMISSIONER